



**Rocky Mountain
Oil & Gas Association**

1775 Sherman Street, Suite 2501 • Denver, Colorado 80203-4313
303/860-0099 • FAX 303/860-0310

Cliff Dodge
Executive Vice President
and General Manager

September 22, 1997



Mr. David S. Guzy
Chief, Rules and Procedures Staff
Minerals Management Service
Royalty Management Program
P.O. Box 25165, Mail Stop 3101
Denver, CO 80225-0165

RE: Rocky Mountain Oil and Gas Association comments on MMS Notice,
"Amendments to Gas Valuation Regulations for Federal Leases," 30 CFR 202,
206 and 211; 62 FR 19535 (April 22, 1997).

Dear Mr. Guzy:

The Rocky Mountain Oil and Gas Association (RMOGA) welcomes this opportunity to submit comments on MMS' April 22, 1997 notice, 62 FR 19536, withdrawing its November 6, 1995 proposed rulemaking. RMOGA is a trade association whose members are responsible for 90 percent of the exploration, production, refining, marketing and transportation of oil and gas in the eight-state Rocky Mountain region.

RMOGA and many of its members participated actively in the lengthy "Negotiated Rulemaking" process that was the precursor of the proposed rule put forth by MMS. Because of the strong interest of our RMOGA membership, we feel compelled to offer the following comments.

It seems quite obvious to RMOGA that MMS has had a dramatic change of opinion regarding the procedure it established and with the results. This process was a time-consuming and costly process that arrived at a shared consensus; however, the agency has obviously changed its mind. During the MMS process, the hierarchy of MMS seemed to be willing to deal with very complex issues surrounding royalty valuation by being flexible and entering into negotiations and making compromises. RMOGA remembers that MMS was very proud of the fact that this rulemaking was a success and Director Cynthia Quarterman wrote in glowing terms of this cooperative effort in the March 16, 1995 MMS News Release.

Page Two

The MMS News Release explained that one of the primary goals of the mineral revenue collection program is to assist and encourage payors to submit royalty payments correctly the first time. The release goes on to explain, in addition, MMS is actively examining ways to simplify and streamline aspects of the complex revenue collection process, including the implementation of a multi-constituent approach to resolving royalty-related issues, such as the Federal and Indian Gas Valuation Committees. Quarterman went on to explain that "the rulemakings will result in program changes that reflect the marketplace and simplify royalty valuation, reporting and payment."

The April 22nd MMS Press Release announces the abandonment of the MMS/Industry cooperative effort to achieve consensus. A reading of the press release and the announcement published in the Federal Register reveals several reasons for this unexplained activity:

- The natural gas market is undergoing dramatic change.
- Existing MMS regulations have flexibility, and are the most appropriate means to deal with the continuing changes in the natural gas market.
- MMS does not believe published indices have developed sufficiently to be representative of gross proceeds actually received for lease production.
- Any rule using indices would become complicated because of the requirement to compare them to gross proceeds, thus placing a significant administrative burden on MMS.
- An MMS cost/benefit analysis indicates that the proposed rule would not achieve revenue neutrality.

Because of the withdrawal of the "Negotiated Rulemaking" it appears the MMS has made a conscious decision to retain admittedly unworkable gas valuation regulations. The RMOGA working committee believes that the "alternative options" MMS will revert to are inferior to the "Proposed Rulemaking." As a practical matter, the current options are more complex and less workable than the rejected compromise.

RMOGA disagrees with MMS' reasons for backing away from the agreed-upon compromise. MMS' contention that existing regulations are very flexible, thus most appropriate to deal with changes in the natural gas market flies in the face of history. Since the adoption of the current rules in 1988, they have proved unworkable, with litigation over definitions and benchmarks. By 1990 MMS had concluded that it was a virtual impossibility for lessees to correctly value and report royalty on production from federal leases and issued an advanced notice of proposed rulemaking dealing with correcting the regulations.

Interior Secretary Bruce Babbitt reestablished the Royalty Management Advisory Committee during the deliberations of the Federal Gas Valuation Negotiated Rulemaking Committee. This group agreed that "the existing regulations are unworkable and supported the "Negotiated Rulemaking" since royalty payors are not able to comply with the current regulations, particularly in the current gas market."

Mr. David S. Guzy
Minerals Management Service
September 22, 1997

Page Three

However, the Minerals Management Service now believes that the existing regulations are flexible and provide the most appropriate means to deal with the continuing changes in the gas arena. The members of the RMOGA working committee do not understand why after achieving consensus, Director Quarterman chooses to take a position at odds with a previous MMS Director, the Assistant Secretary of Land and

Minerals Management, and the Secretary of the Interior. It seems that the MMS is saying that a new rule actually was not necessary and that the entire Negotiated Rulemaking process was superfluous.

The RMOGA working committee also is having difficulty understanding MMS pulling away from published indices for natural gas because of fair market value questions, and the suggestion that a safety net calculation would place a significant burden on MMS. After spending months discussing the administrative/audit burden and legal questions regarding determination of the royalty value of production sold downstream of the lease under existing rules, the Rulemaking Committee agreed with MMS that these problems could be avoided with the use of an index-based method and a safety net figured on the arm's-length gross proceeds calculations. During these discussions that led to the compromise, Director Quarterman convinced the Committee the safety net calculation would not be too burdensome for MMS to deal with. Now, in the reasoning for the retraction of the agreed-upon compromise, she insists it would now place a significant burden on MMS. It seems to RMOGA that the Director cannot have it both ways, as she is attempting with this issue.

RMOGA'S working committee was surprised that cost/benefit analysis was used as a reason to withdraw the compromise. The statement that the proposed rule would not achieve revenue neutrality points up a number of interpretations that detract from the reliability of the MMS numbers that suggest an annual deficit of \$20 million. MMS based its conclusion on an MMS study. The NGSA's Foster Study found that, overall, the use of published index prices in calculating royalty payments for gas sold under non-dedicated contracts would approximate gross proceeds based royalty payments to the MMS.

The MMS Study conclusions are confusing. Many price indices report prices based on the average prices, or most frequently quoted prices, for gas sales at a particular delivery point. Thus, a representative sample of actual sales made at the same point as the reported index points to average out at the reported index prices. However, according to MMS's analysis, apparently most federal gas is sold at above these index prices. To borrow a phrase from the Natural Gas Supply Association, "NGSA suspects that differing results reached by the MMS study, in comparison to the Foster's Study, may reflect MMS's methodology for adjusting for transportation deductions and perhaps adjustments based on its safety-net calculations."

Mr. David S. Guzy
Minerals Management Service
September 22, 1997

Page Four

The RMOGA working committee wishes to remind MMS that the so-called MMS new options were considered, discussed and rejected by the Rulemaking Committee as not workable. I am referring to the Index +/- "X factor" method, and the "index + X" option. In addition, the "Norway Method" was rejected as merely a re-packaged "secretarial established value."

The RMOGA working committee suggests that there is an alternative to all of the proposed options that MMS has been looking at. Despite the fact that we favor the agreed-upon compromise in the "Negotiated Rulemaking", we offer the following solution to this vexing problem.

ROYALTY-IN-KIND PROGRAM:

In all of our discussions with individual companies and a wide variety of trade associations, one central theme continues to bubble to the top of everyone's list...a Royalty-In-Kind program for the federal government's share of natural gas production that is "scored" accurately to assure revenue neutrality or even monetary gain for the federal government. This solution to this problem of gas valuation would give the federal government assurances that it is receiving full value for its gas by taking possession of it at or near the lease, and selling it to buyers with differing economic interests. Such a program should have a set of principles that must be adhered to in order to ensure fairness and full participation within the private sector.

Such a Royalty-In-Kind Program should:

1. Reduce administrative and compliance burdens while providing the opportunity for federal and state governments to maximize their revenues.
2. Require transactions at or near the lease that fulfill the lease obligations.
3. Provide that when the government elects to take "in kind" it must take all royalty production for a specified period of time.
4. Require the use of private marketing expertise to streamline government operations.
5. Provide the states with the opportunity to be involved in designing and implementing the program.
6. Make production taken "in kind" broadly available for public purchase.

CONCLUSION:

The RMOGA working group is very disappointed that MMS chose to withdraw the agreed-upon compromise in the "Negotiated Rulemaking." After so much time and effort, the results were clearly superior to the current valuation procedure. However, the best of all answers lies in the adoption of a Royalty-In-Kind program for the federal government, and this turn of events gives MMS the opportunity to back away from a

Mr. David S. Guzy
Minerals Management Service
September 22, 1997

Page Five

system that has clearly failed and set up a new system embracing Royalty-In-Kind. We strongly support this effort.

Let us make it very clear that the Rocky Mountain Oil and Gas Association prefers the adoption of a Royalty-In-Kind program. However, RMOGA also believes that either the "Consensus Report" or the "Negotiated Rulemaking" is preferable to the current method.

RMOGA thanks the Minerals Management Service for the opportunity to participate in this most important discussion.

Sincerely,

A handwritten signature in black ink, appearing to read "Cliff F. Dodge". The signature is fluid and cursive, with the first name "Cliff" and last name "Dodge" clearly distinguishable.

Clifford F. Dodge
Executive Vice President
Rocky Mountain Oil and Gas Association